

ANALYSIS OF ORIGINAL BILL

Author: Hollingsworth, et al. Analyst: Darrine Distefano Bill Number: SB 1147
Related Bills: See Legislative History Telephone: 845-6458 Introduced Date: 01-26-2004
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT:

Disaster Loss Deduction/Excess Loss Carryover/Los Angeles, San Bernardino, Riverside, San Diego, & Ventura County Fires

SUMMARY

This bill would allow taxpayers special tax treatment, called disaster loss treatment, for losses sustained as a result of the Southern California wildfires that occurred in October and November of 2003.

This analysis will not address the provisions related to property tax, as they do not impact the department.

PURPOSE OF THE BILL

According to the author's staff, the purpose of the bill is to provide tax relief to individuals affected by recent California disasters.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective and operative for taxable years beginning on or after January 1, 2004.

POSITION

Pending.

Summary of Suggested Amendments

Amendments are provided to add clarification, to include damage from floods, mudflows, and debris flows that occurred as a direct result of the wildfires, and for damage that occurred as a result of the San Simeon earthquake.

ANALYSIS**FEDERAL/STATE LAW**

Under federal and state law, a disaster loss occurs when property is destroyed as a result of a fire, storm, flood, or other natural event in an area proclaimed to be a disaster by the President of the United States or, for state law purposes, by the Governor.

Board Position:

| | | |
|----------|-----------|----------------------|
| _____ S | _____ NA | _____ NP |
| _____ SA | _____ O | _____ NAR |
| _____ N | _____ OUA | <u> X </u> PENDING |

Department Director

Date

Gerald H. Goldberg

2/13/04

Under federal and state tax law, the taxpayer may elect to claim the loss either in the year the loss occurs or in the year preceding the loss. This election allows the taxpayer to file an amended return immediately for the prior year. For state purposes, this election may be made prior to passage of any state legislation allowing special carryover treatment because California conforms to the federal election.

Nonbusiness disaster losses not reimbursed by insurance or otherwise are deductible under state and federal tax law to the extent each loss exceeds \$100. Total nonbusiness disaster losses are deductible only to the extent that the total loss amount for the year exceeds 10% of adjusted gross income.

State tax law identifies specific events as disasters that are then allowed additional special carry forward treatment. That is, 100% of the excess disaster loss may be carried over for up to five taxable years, and if any excess loss remains after the five-year period, the remaining excess loss may be carried over at a specified percentage for up to 10 additional years.

THIS BILL

This bill would add the wildfires that occurred in October and November of 2003 in the Counties of Los Angeles, San Bernardino, Riverside, San Diego, and Ventura to the current list of specified disasters under the Personal Income Tax Law (PITL) and the Corporation Tax Law (CTL). Specifically, this bill would allow special disaster treatment of losses sustained as a result of those wildfires. The \$100 and 10% of adjusted gross income limitations in existing law would apply to disaster losses on nonbusiness property.

IMPLEMENTATION CONSIDERATIONS

Implementing this bill would not significantly impact the department's programs and operations.

TECHNICAL CONSIDERATIONS

The Governor requested and the President authorized the Federal Emergency Management Agency to expand the disaster declaration to include floods, mudflows, and debris flows that were a direct result of the Southern California wildfires. The Governor has also declared the San Simeon earthquake a disaster. Amendments 1 and 5 are provided at the author's request to add to the list of specified disasters both the expanded damages resulting from the wildfires and to add language for losses resulting from the earthquake that occurred in the Counties of San Luis Obispo and Santa Barbara. Amendments 4 and 8 allow taxpayers affected by the earthquake to claim the loss either in the year the loss occurs or in the year preceding the loss.

Also, clarifying amendments have been included under the PITL and CTL. Amendments 2 and 6 clarify the net operating loss percentage applicable for excess disaster loss. The wildfires occurred in 2003 when the applicable percentage for net operating loss (NOL) was 60%. Therefore, if a taxpayer affected by the wildfires has any excess disaster loss remaining after five years, 60% of the remaining loss can be carried over for an additional 10 years.

Amendments 3 and 7 eliminate unnecessary language and clarify that for state income tax purposes federal treatment for disasters applies to a Governor-only declared disaster.

LEGISLATIVE HISTORY

- AB 1X (Cardoza, Stats. 1997, Ch. X3) covered losses for the storms and floods of 1996-97.
- AB 2456 (Sweeney, Stats. 1998, Ch. 749) covered losses for the storms and floods of February 1998.
- AB 114 (Florez, Stats. 1999, Ch. 165) covered losses for the winter freeze of 1998-99.
- AB 44 (Wiggins, Stat. 2001, Ch. 618) covered losses for the earthquake that occurred September 2000 in Napa, California.
- SB 438 (Soto, 2003/2004) is identical to SB 1147, except for clarifying amendments. SB 438 is in the Assembly Revenue & Taxation Committee.

OTHER STATES' INFORMATION

Michigan, Minnesota, Massachusetts, and New York conform to the federal provisions that allow taxpayers to claim a disaster loss deduction on their state returns either in the preceding year or in the year of the loss. It appears that legislation, executive order, or proclamation by the President or the Governor is required to identify the area impacted by a disaster that is eligible for federal or state assistance.

Florida does not have a personal income tax. However, monetary relief is provided to citizens and corporations through the Emergency Management, Preparedness, and Assistance Trust Fund. Florida also requires legislation, executive order, or proclamation to identify the area impacted by a disaster.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

Based on the discussion below, the revenue losses from this bill are as follows (assumes legislation enacted after June 30, 2004):

| Estimated PIT Revenue Impact SB 1147 as Introduced January 26, 2004, with proposed amendments (In Millions) Fiscal Year Impact | | |
|---|----------------|----------------|
| 2004-05 | 2005-06 | 2006-07 |
| -\$5 | -\$9 | -\$4 |

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this proposal.

Revenue Discussion

The impact of this bill would depend on the amount of disaster losses carried back, carried forward at 100% instead of 60%, and the amount of carryover losses deducted in subsequent years.

The estimated losses were determined in several steps. First, it is assumed that the special disaster loss treatment provided in this bill would be for losses sustained as a result of the Southern California wildfires, the expanded wildfire disaster coverage, and the San Simeon earthquake. Second, the total amount of damages for the Southern California wildfires was estimated to be \$2.8 billion and the total amount of damages from the San Simeon earthquake was estimated to be \$34 million in private losses.

It is estimated that approximately 20% of fire damages and 90% of the earthquake damage would not be reimbursed by insurance coverage for a total deductible loss of \$590 million ($\$2.8 \text{ billion} \times 20\% + \$34 \text{ million} \times 90\% = \590 million).

In order for a taxpayer to calculate the amount of disaster loss that can be deducted, the taxpayer uses three factors. First, the loss must be limited to the basis of the property (cost of the property plus cost of any improvements minus deductions such as depreciation). Second, any insurance proceeds or reimbursements must be deducted. Third, the taxpayer subtracts 10% of their federal adjusted gross income (AGI). The remaining amount is the disaster loss that can be claimed by the taxpayer. Using the department's disaster loss model, after applying qualifying losses for AGI and basis limitations of \$147 million and an estimated first year usage of \$148 million (historical use of similar losses under current law), it is projected that \$250 million in losses would be allowed to be carried forward under the bill ($\$590 \text{ million} - \$147 \text{ million} - \$148 \text{ million} = \295 million).

At a 6% average marginal tax rate, the total revenue loss over a period of a few fiscal years is estimated to be approximately \$18 million, all attributable under the PITL ($\$295 \text{ million} \times 6\% \sim \18 million).

LEGISLATIVE STAFF CONTACT

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO SB 1147
As Introduced January 26, 2004

AMENDMENT 1

On page 5, line 25, strikeout "." and insert:

, or as a result of floods, mudflows, and debris flows directly related to the fires in those counties from October 21, 2003, through February 2, 2004.

(23) Any loss sustained as a result of earthquakes or any other related casualty occurring in December 2003 in the Counties of San Luis Obispo and Santa Barbara.

AMENDMENT 2

On page 5, line 33, after "17276" insert:

operative for the year the disaster loss was sustained,

AMENDMENT 3

On page 6, strikeout lines 8-11 and insert:

(d) Section 165(i) of the Internal Revenue Code shall be modified to additionally apply to any of the losses listed in subdivision (a) which was proclaimed by the Governor to be in a state of disaster.

AMENDMENT 4

On page 6, line 19, strikeout "(22)" and insert:

(23)

AMENDMENT 5

On page 8, line 18, strikeout "." and insert:

, or as a result of floods, mudflows, and debris flows directly related to the fires in those counties from October 21, 2003, through February 2, 2004.

(23) Any loss sustained as a result of earthquakes or any other related casualty occurring in December 2003 in the Counties of San Luis Obispo and Santa Barbara.

AMENDMENT 6

On page 8, line 25, after "24416" insert:

operative for the year the disaster loss was sustained,

AMENDMENT 7

On page 8, strikeout lines 39-40, on page 9, strikeout lines 1-2, and insert:

(d) Section 165(i) of the Internal Revenue Code shall be modified to additionally apply to any of the losses listed in subdivision (a) which was proclaimed by the Governor to be in a state of disaster.

AMENDMENT 8

On page 9, line 12, strikeout "(22)" and insert:

(23)